DOCUMENT RESUME

ED 281 224 CS 210 451

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TITLE Evidence of a "Failing Newspaper" under the Newspaper Preservation Act.
PUB DATE Aug 87
NOTE 19p.; Paper presented at the Annual Meeting of the Association for Education in Journalism and Mass Communication (70th, San Antonio, TX, August 1-4, 1987).
PUB TYPE Reports - Research/Technical (143) -- Speeches/Conference Papers (150)

EDRS PRICE MF01/PC01 Plus Postage.
DESCRIPTORS Competition; Court Litigation; *Evaluation Criteria; Evaluation Methods; *Failure; Media Research; Mergers; *Newspapers; *Performance Factors
IDENTIFIERS *Newspaper Circulation; *Newspaper Preservation Act 1970

ABSTRACT

The Newspaper Preservation Act of 1970 makes it possible for competing newspapers to combine advertising, production, circulation and management functions into a single newspaper corporation. For the attorney general and the courts to authorize a joint operating agreement (JOA) for a "failing newspaper," certain conditions must be met and certain types of financial and economic data must be examined. The most significant test of failure is whether a "circulation spiral" (indicated by circulation and advertising performance) exists, and a second major test is whether a significant disparity exists between the circulation and advertising shares of the two competing papers. Financial losses comprise the third major test in determining whether a paper is failing. A review of 57 newspapers that failed or merged during the past decade suggests that the majority of such failures and mergers has taken place in small- and mid-sized markets rather than in large metropolitan markets. The information also indicates that when the 60% to 40% circulation split is reached, continued operation of two papers becomes unprofitable. These three main tests of failure provide five indicators by which to judge whether failure exists, and newspapers in four of the five cities already granted JOAs (Anchorage, Alaska; Chattanooga, Tennessee; Cincinnati, Ohio; and Seattle, Washington) passed at least four of the five tests. The "Detroit Free Press," currently seeking JOA approval, does not pass the majority of the five tests, and, in fact, provides only two of the five indicators of failure. (Two pages of notes and three tables are included.) (NKA)

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EVIDENCE OF A 'FAILING NEWSPAPER' UNDER THE NEWSPAPER PRESERVATION ACT

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A paper presented to the Newspaper Division at the Annual Meeting of the Association for Education in Journalism and Mass Communication, San Antonio, Texas, August 1-4, 1987

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EVIDENCE OF A "FAILING NEWSPAPER" UNDER THE NEWSPAPER PRESERVATION ACT

The Newspaper Preservation Act of 1970 makes it possible for competing newspapers to combine advertising, promotion, production, circulation, and management functions into a single newspaper corporation. This provides economies of scale to both papers in the combined operation, an important means of maintaining two papers in one city. In addition, the act allows jointly operating papers to engage in price fixing, market allocation, and profit pooling, and establishes monopoly power over a market, actions that are normally prohibited by antitrust laws.

In order to enter such a joint operating agreement (JOA), one of the papers published in the market must prove to the satisfaction of the U.S. attorney general that it is a failing newspaper, that is, "in probable danger of financial failure."[1] Twenty-two papers that established JOAs prior to passage of the Newspaper Preservation Act were permitted to continue operating under a "grandfather clause." Since the legislation was enacted, papers in four cities have sought to and been permitted to establish JOAs: Anchorage, Alaska; Chattanooga, Tennessee; Cincinnati, Ohio; and Seattle, Washington. Newspapers in Detroit, Michigan, are now seeking to join that number.[2]

This article considers the tests of failure used by the attorney general and the courts in determining whether papers may be permitted to operate jointly and considers how well the five papers that have sought JOAS since 1970 have met the specified criteria.

The "Failing Company" Doctrine and Its Repudiation

Prior to passage of the Newspaper Preservation Act, the determinations of whether a firm was failing were set forth in the "failing company" doctrine, established in International Shoe Co. v. FTC[3] and subsequent case and statutory law, that provided that a firm that could show it was failing could merge with a competitor notwithstanding laws normally intended to prevent mergers that would reduce competition between the two firms. The defense against antitrust could be put maintained if 1) the merger was made without anticompetitive intent, 2)there were no other prospective purchasers for the firm being acquired, and 3) one of the firms was in immediate danger of collapse.[4] These tests of the "failing company" doctrine are intentionally strict and were enacted to make mergers between competing companies difficult.

When the U.S. Supreme Court considered the issue of joint operating agreements between newspapers in Citizen Publishing Co. v. U.S. 1969,[5] it held that a newspaper could put forth the "failing company" defense to justify a joint operating agreement if it showed 1) that the paper was on the brink of failure, 2) that the acquiring company was the only available purchaser, and 3) that the company being acquired could not be saved by reorganization. The court ruled, however, that the Citizen Publishing Co. did not meet these tests of company failure and upheld a district court order to break up the joint operating agreement.

That ruling led to efforts by the newspaper industry to seek passage of the Newspaper Preservation Act, which was intended to protect newspapers already operating under JOAs and which

specified that future agreements would require the approval of the attorney general. Spokesmen for the industry argued that newspaper competition differs from competition in other industries and that for separate newspaper voices to survive, competing papers would have to join together before the rigid conditions of failure under the "failing company" tests could be met. Congress accepted these arguments and passed the act.

As a result, the Newspaper Preservation Act made failure easier to assert by specifying that a "failing newspapers" meant "a newspaper publication, which, regardless of ownership or affiliations, is in probable danger of financial failure." The construction of the statute and the legislative intent clearly repudiated the "failing company" doctrine, and its application in Citizen Publishing Co., allowing papers to enter such arrangements when their financial distress was evident but before they reached a point at which absolutely no possibility for survival existed without a JOA.[6]

The possibility of alternative purchasers was raised a decade after passage of the act when the application for the Seattle JOA was made, but the attorney general ruled that the "failing newspaper" doctrine does not require that no alternative purchasers exist. The Ninth Circuit Court of Appeals concurred, ruling that the existence of willing buyers might be relevant to the application for a JOA, but that their existence would not preclude a finding that the paper is failing if its management was reasonable and prudent, and if its owners could show that prospective purchasers would not solve the paper's economic difficulties.[7]

Indicators of Failure Under the "Failing Newspaper" Doctrine

This paper examines the evidence that the attorney general and the courts have considered as appropriate indicators of a "failing newspaper" in a JOA application, and what types and how much economic and financial data are used in these indicators. It will also explore how the papers in the five cities that have sought joint operating agreements have performed on these specific tests of failure.

In decisions involving whether or not JOAs should be permitted in the cases, three main tests have been administered to determine whether a paper meets the "failing newspaper" doctrine put forth in the Newspaper Preservation Act.

The first and most significant test is whether the "circulation spiral" exists. This phenomenon is evidenced by declining circulation levels that result in a decline in advertising levels that cannot be attributed to general decline in the economy but to the fortunes of competition and the decline in circulation.

The newspaper with the largest circulation in a given market has advantages that enable it to gain ground in both circulation and advertising revenues at the expense of the paper with lower circulation, thus forcing the smaller paper into a less advantageous situation, according to economist Lars Furhoff.[8] The leading paper then has the advantage in determining the standards of advertising, editorial, production, and distribution quality, thus putting increased pressure on the competing paper to respond. This increases the smaller paper's economic difficulties and traps it in a circulation spiral that aggravates the problem of selling

advertising space.[9] Thus, two indicators are used to find evidence of the circulation spiral: circulation performance and advertising performance.

The difficulties posed by the downward spiral of circulation and, consequently, advertising were recognized during efforts to enact legislation and were introduced as testimony in the hearings on the application for the Seattle JOA in 1981.[10] Case law resulting from the Seattle application recognized the importance of the spiral as a factor in establishing newspaper failure. The court said, "Generally...the burden only entails a showing of (1) the economic fact of probable failure (downward spiral, irreversible losses), and (2) reasonable management practices."[11]

The second major test of failure is whether a significant disparity exists between the circulation and advertising shares of the two competing papers. No standard circulation share level at which the smaller of two competing general circulation daily newspapers cannot survive has been established and fully accepted in the newspaper industry. However, it is generally accepted in the industry that a serious problem is evident when a 60 to 40 percent split develops.

A review by this author of 20 competing daily newspapers that discontinued publication between 1976 and 1985 found that the average share split for dying papers was 31.9 percent, compared to 68.1 percent for the surviving competitor. The papers that ceased publication had an average circulation of 79,825, compared to an average circulation of 170,076 for the surviving paper.[12]

A similar review of 37 papers that merged during the period revealed an average circulation share split of 39.2 percent for

the smaller paper and 60.8 percent for the larger paper. The average circulation of the smaller paper was 40,790 and the average for the larger paper was 63,394. In nearly every case, the merging papers were owned by the same company.[13]

These two sets of figures suggest that the majority of the shakeout during the past decade has been taking place in small- and mid-sized markets rather than in large metropolitan markets. The data further indicate that when the 60 to 40 percent circulation split is reached, continued operation of two papers becomes unprofitable. This is evidenced in the data for merging papers where, without the impetus of real competition, morning and evening papers often merged. Where real competition existed, seen in the papers that ceased publication altogether, the split was 68 to 32 percent. This evidences a point beyond which losses appear to be too great for a firm to control by cost cutting measures or new marketing efforts to regain circulation.

Based on these two sets of data, it is reasonable to assert that a 55 to 45 percent circulation split is an indicator of a serious disparity and that a 60 to 40 percent circulation share split is the critical point in the circulation levels. When papers fall below that point, their ability to survive is questionable.

Advertising shares, measured by the percent of revenues or lineage, are equally important. An industry rule-of-thumb states that when the split between two papers exceeds approximately 55 to 45 percent, the disparity begins to become serious. In situations where the split is more than 60 to 40 percent, it becomes critical. Thus the significance of the 55-44 and 60-4 share split apply to both advertising and circulation.

These two indicators are important because there is an interaction between circulation share and advertising share of newspapers. A disproportionate share of advertising is given to the paper with the largest circulation. This disproportionality is illustrated by Figure 1. When a paper exceeds the 50 percent circulation level, its share of advertising is disproportionately high. For instance, a paper with a 60 percent share of circulation will generally have an advertising share of approximately 75 percent. When the circulation share is low, for example, 40 percent, the advertising share will generally be approximately 25 percent.

The third major test in determining whether a paper is failing are financial losses. In this case, the relevant measure is real operating losses that are unlikely to be reversed. Determination that "irreversible losses" are a factor was somewhat tempered by the Ninth Circuit Court of Appeals when it stated in its opinion on the Seattle application that newspapers are to be prevented "from allowing or encouraging financial difficulties in the hopes of reaping long-term financial gains through a JOA."[14]

The desire to ensure that losses are real and irreversible and not the result of internal management decisions was seen in 1979 in the decision of the administrative law judge in the application for the Cincinnati joint operating agreement. In that decision, the judge ruled that overcharges from news, feature, and advertising services related to the E. W. Scripps Co. had to be eliminated before he would make a determination whether the Cincinnati Post was a failing newspaper.[15]

Evidence of Failure in JOA Applicants Since 1970

Given these accepted indicators of the failure of a newspaper, this study considered the degree to which the newspapers seeking or that have been granted permission to form joint operating agreements since passage of the Newspaper Preservation Act of 1970 met or meet the elements in the three primary indicators of failure.

The Circulation Spiral

The first indicator is the presence of the "circulation spiral," that is, losses in circulation and advertising. Of the five papers seeking JOAs, only four provided evidence of the existence of the spiral.

In Anchorage, the News' circulation declined from 16,551 in 1965 to 15,079 in 1973. During the same period, the circulation of the rival Times rose from 28,988 to 41,069. The advertising situation of the News paralleled its declining circulation situation, a problem that was compounded because the Times was able to sell advertising at half the milline rate of the News.

In the case of the Chattanooga Times, the spiral was evident in a decrease in circulation from 58,907 in 1975 to 51,072 in 1979 and in the Times' decreasing share of ad revenue from 50 percent in 1976 to 45.1 percent in 1979.

In Cincinnati, the Post experienced a decrease in circulation from 252,000 in 1964 to 181,842 in 1979 and a decrease in advertising revenue share from 36.1 percent in 1975 to approximately 15 percent in 1977.

The Detroit Free Press, which is currently seeking "failing newspaper" status, experienced an increase in circulation from 605,156 in 1980 to 644,778 in 1985. Its ad revenue share increased from 38.2 percent in 1981 to 38.4 percent in 1985.

The Seattle Post-Intelligencer evidenced a decrease in circulation from 213,171 in 1961 to 182,475 in 1981. Its ad revenue share decreased from 33.4 percent in 1976 to 29.5 percent in 1980.

Circulation/Advertising Disparity

The sizes of the gaps between circulation and advertising shares of the two competing papers in each of the five markets just prior to establishment of JOAs are unique to each situation, but the papers' performances conform to the anticipated economic patterns of disparity put forth in Figure 1.

In terms of circulation share, the Anchorage News was clearly at a disadvantage with only 26.9 percent of total circulation in its market in 1973, compared with a 73.1 percent share for the Anchorage Times.

In Chattanooga, the News-Free Press garnered 53.5 percent of total circulation, 54.3 percent of metro area circulation, and 53.7 percent of city zone circulation in 1979. In contrast the Times had a total circulation of only 46.5 percent, with 45.7 percent of the metro area circulation and 46.8 percent of city zone circulation.

The Cincinnati circulation share split was much tighter. In 1979, for example, the Enquirer accounted for 50.7 percent of total circulation, 48.6 percent of metro area circulation, and

49.5 percent of city zone circulation. The competing Post garnered 49.3 percent of total circulation, 51.4 percent of metro, circulation and 50.5 percent of city zone circulation.

The Detroit circulation share split was also tight when it applied for a JOA in 1985. The Free Press held 49.6 percent of the total circulation, 45.0 percent of the primary marketing area circulation, and 46 percent of the city and retail trading zone circulation. The competing News garnered 51.4 percent of the total circulation, with 55 percent of the circulation in the primary marketing area and 54 percent of the circulation in the city and retail trading zones.

In 1980, the Seattle Post-Intelligencer held 43.3 percent of total circulation, 37.1 percent of the metro area circulation, and 37.2 percent of city zone circ circulation. By comparison, the Times accounted for 56.7 percent of total circulation, 62.9 percent of metro area circulation and 62.8 percent of city zone circulation.

Similar discrepancies existed in terms of advertising shares for the papers. In Anchorage, the Times enjoyed a 3 to 1 advantage over the News in 1973, receiving approximately 75 percent of the advertising shares. The Chattanooga Times accounted for 45.1 percent of the shares in that city in 1979, compared to 54.9 percent for the News-Free Press. In Cincinnati in 1976, the Enquirer garnered a 65.5 percent share of advertising, while the Post acquired only 34.5 percent. The Detroit ad shares in 1985 also revealed a wide split. The News was responsible for 61.6 percent of the shares, and the Free Press accounting for 38.4 percent.

In Seattle in 1980, the Post-Intelligencer held only 29.5 percent of the advertising share compared to 70.5 percent for the Times.

The disparity between circulation and advertising shares of papers seeking joint operating agreements since 1970 is clearly seen in Figure 2.

Financial Losses

The third indicator of failure is financial losses, measured in dollars or as a portion of revenues. In Anchorage, for instance, losses for the News averaged 49 percent of revenues from 1966-1974, and averaged $500,000 annually from 1969 to 1974.

In Chattanooga, losses for the Times rose significantly in the four years prior to its application for a joint operating agreement. Losses of $377,000 in 1976 grew to $1.2 million in 1979.

Losses for the Cincinnati Post were 4.5 percent of revenues in 1977, the Detroit Free Press encountered losses of 5.2 percent of revenues in 1985, and the Seattle Post-Intelligencer lost 3.9 percent of revenues in 1980.

Indicator Patterns

The three factors of failure provide five indicators by which to judge whether failure exists. The five papers that have sought joint operating agreements have had different patterns of indicators of failure, as revealed in Figure 3.

Of the papers granted JOAs, all passed at least four of the tests of failure, with the Anchorage News and Seattle Post-

Intelligencer scoring perfect 5s.

Only the Detroit Free-Press, which is currently seeking JOA approval, does not pass the majority of the five tests, for it provides only two of the five indicators of failure. It shows no evidence of the circulation spiral. In fact, the data indicate that the paper is moving upward, not downward, in both circulation and advertising. The disparity of circulation between the Free Press and the News has not yet reached the "serious" disparity level, a third important indicator.

The Free Press only provides evidence of difficulty in two areas, in the disparity in advertising shares between itself and the News and financial losses. Interestingly, the News--which is purportedly the "successful" paper--has a pattern nearly identical to that of the Free Press, with the exception of being on the preferential end of the disparity between advertising shares. The News' losses have paralleled those of the Free Press.

Whether the Free Press' indicators are enough to justify a ruling that the paper constitutes a "failing newspaper" remains to be seen. For the attorney general to accept the application of the Detroit papers, however, his staff must lower the threshold of "failure" significantly.

NOTES

1. Newspaper Preservation Act, 15 U.S.C. $$ 1803(b).

2. The papers in Anchorage, Alaska, terminated their agreement after five years of operation and are now competitors once again.

3. International Shoe Co. v. FTC, 280 U.S. 291, 74 L.Ed. 431, 50 S.Ct. 89 (1930)

4. See Steven W. Phillips, "The Joint Newspaper Operating Case: A Facelifting for the Failing Company Doctrine," Arizona Law Review 11:531-550 (1969); John P. Patkus, "The Newspaper Preservation Act: Why It Fails to Preserve Newspapers," Akron Law Review 17:435-452 (1984); and Gail Lund Barwis, "The Newspaper Preservation Act: A Retrospective Analysis," Newspaper Research Journal 1:27-38 (February 1980).

5. Citizen Publishing Co. v. U.S., 394 U.S. 131, 22 L. Ed. 2d 148, 89 S.Ct. 927 (1969).

6. See Recommended Decision of Donald R. Moore, Administrative Law Judge, in the Application by the Cincinnati Enquirer, Inc., and the E.W. Scripps Company for a Joint Operating Agreement Before the Attorney General of the United States, Docket No. 44-03-24-4, pp. 118-128.

7. Committee For An Independent Post-Intelligencer v. Hearst Corporation, 70 F.2d 467 (9th Cir. 1983); cert. den. 464 U.S. 892 (1983).

8. See Lars Furhoff, "Some Reflections on Newspaper Concentration," Scandinavian Economic History Review 21 (1973), p.

9. See Ibid.; Karl Erik Gustafsson, "The Circulation Spiral and the Principle of Household Coverage," Scandinavian Economic History Review 28: 1-14 (1978); and Lars Engwall, "Newspaper Competition: A Case for Theories of Oligopoly," Scandinavian Economic History Review 29:145-154 (1981).

10. See Sen. Daniel Inouye's remarks in the Congressional Record, Jan. 29, 1970; James N. Rosse, Testimony Before the Attorney General of the United States, Docket 44-03-24-06, transcript pages 550, 640-641 and John Morton, Testimony Before the Attorney General of the United States, Docket 44-03-24-06, transcript pages 275-277.

11. Committee For An Independent Post-Intelligencer v. Hearst Corporation. 704 F.2d 478 (9th Cir. 1983). Emphasis added.

12. The data were calculated by establishing the mean circulations and circulation shares for both dying and surviving daily papers in the markets. Papers included were from the following markets: 1976--Hartford, Ct; 1977--Cleveland, TN and State College, PA; 1978--Chicago, IL; Goleta, CA; 1979--Campaign-Urbana, IL; East St. Louis, IL; 1980--Paterson, NJ; Oklahoma City, OK; Madison, WI; 1981--Rogers, AR; Washington, D.C.; Philadelphia, PA; Austin, TX; 1982--Buffalo, NY; White Plains, NY; Cleveland, OH; 1984--North Las Vegas, NV; Woodstock, IL; and Dover, NJ.

13. Papers included were from the following markets: 1977--Meridien, MS; Alma, MI; Roanoke, VA; 1978--McAlester, OK; Berkeley, CA; Dunn, NY; Palo Alto, CA; Beaver Falls, PA; Huntington, WV; 1980--Topeka, KS; Wichita, KS; Monroe, LA; New Orleans, LA; Salem, OR; Allentown, PA; Uniontown, PA; Kingsport, TN; 1981--Oakland, CA; Sarasota, FL; Tampa, FL; Des Moines, IA; Lexington, KY; Duluth, MN; Minneapolis, MN; Fulton, MO; Long Beach, CA; Anderson, SC; 1982--Sylacauga, AL; Springfield, OH; Little Falls, MN; Portland, OR; Spartansburg, SC; 1984--Huntington Park, CA; 1985--Pensacola, FL; St. Paul, MN; Biloxi, MS; Binghampton, NY; Bristol, TN.

14. Committee For An Independent Post-Intelligencer v. Hearst Corporation, 704 F.2d at 478.

15. Recommended Decision of Donald R. Moore, Administrative Law Judge, Docket 44-03-24-4, p. 56.

Figure 1

Disparity Between Ad and Circulation Shares

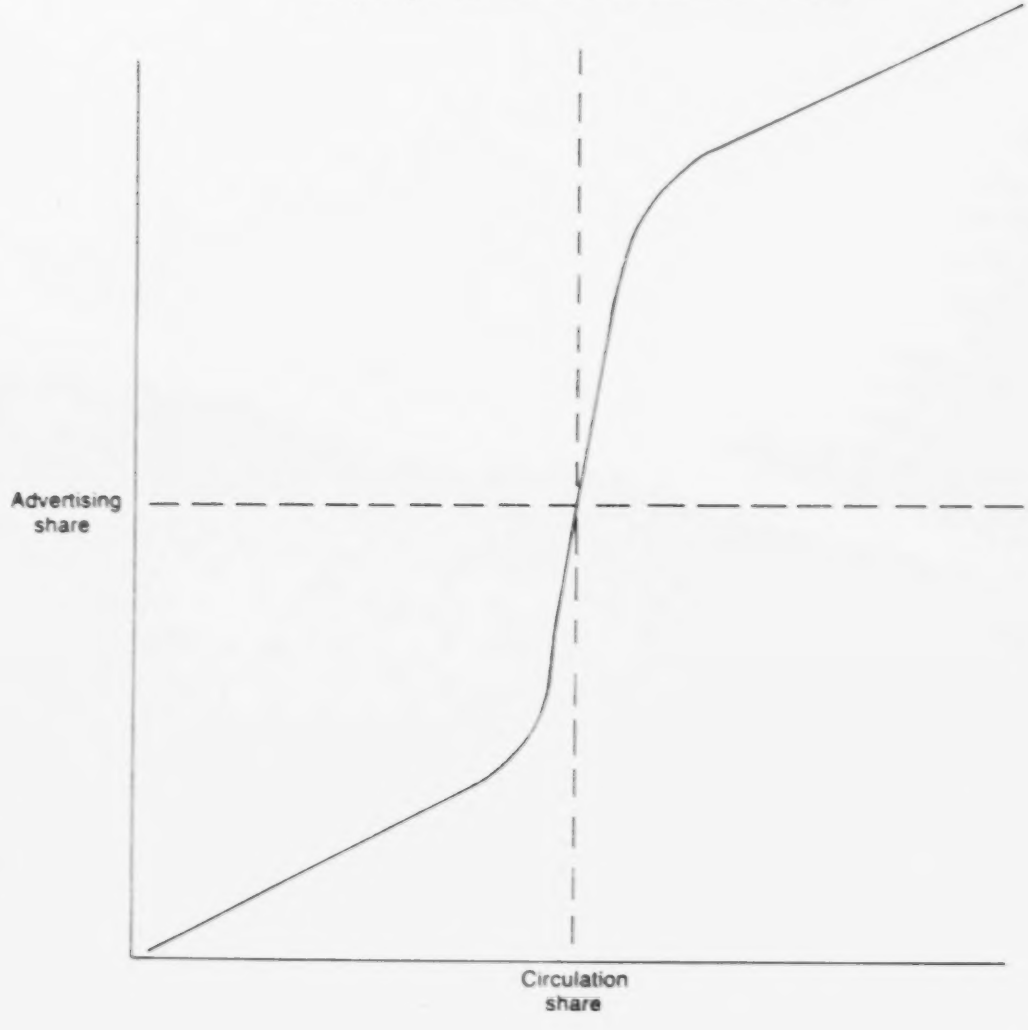

Figure 2

DISPARITY BETWEEN ADVERTISING AND CIRCULATION SHARES

IN PAPERS ENTERING JOINT OPERATING AGREEMENTS SINCE 1970

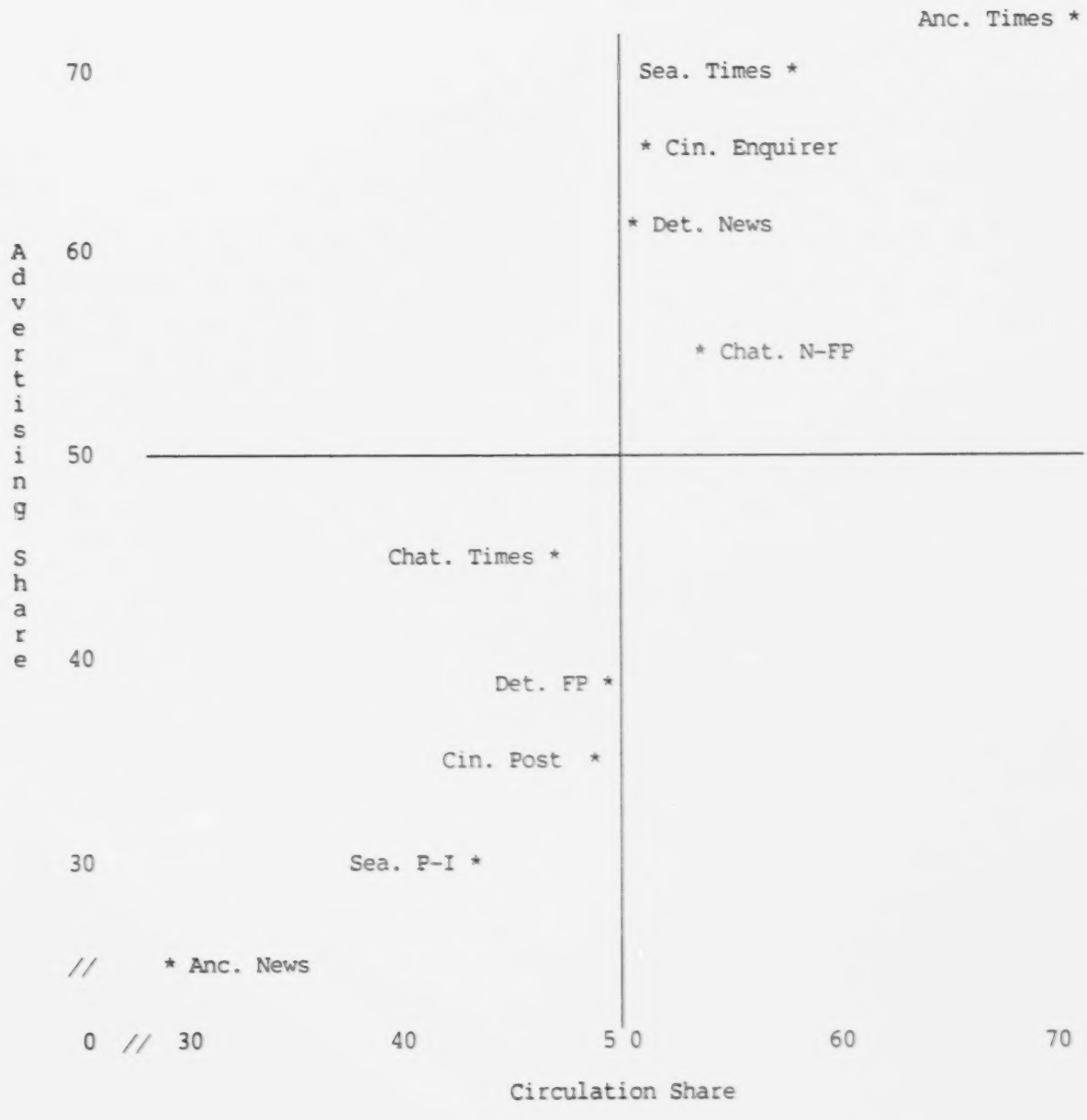

Figure 3

INDICATORS OF FAILURE IN NEWSPAPERS SEEKING JOAS

	Circ. Spiral		Disparity			Total
	Circ. Loss	Ad. Loss	Circ.	Ad.	Fin. Loss	Yes
Anch.	Y	Y	Y-C	Y-C	Y	5
Chat.	Y	Y	N	Y-S	Y	4
Detroit	N	N	N	Y-C	Y	2
Cin.	Y	Y	N	Y-C	Y	4
Seattle	Y	Y	Y-S	Y-C	Y	5
Total Yes	4	4	2	5	5	

Y-S = Yes, serious disparity
Y-C = Yes, critical disparity